“Shrinking the Safety Net: The 2005 Changes in U.S. Bankruptcy Law”

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by Robert M. Lawless & Elizabeth Warren

Abstract

As part of an international symposium on consumer bankruptcy, we address some of the 2005 changes in the U.S. bankruptcy law. We outline briefly the political climate that led to the 2005 changes, and then we examine the four changes that are likely to have the greatest effect on families in financial trouble. We single out the new consumer credit counseling requirements as providing virtually no help to debtors, serving instead as one more costly hurdle a debtor must jump before filing bankruptcy. Means testing for chapter 7 eligibility has created confusion and perverse incentives for debtors. New burdens and restrictions on attorneys have increased the cost of legal representation. Finally, although not as widely publicized as other changes, new rules requiring audits of bankruptcy filings could significantly change how bankruptcy filers assert legal positions in their petitions and schedules. After considering these changes, we describe the plans of the 2007 Consumer Bankruptcy Project to go into the field to collect data on more than 2,000 bankruptcy filers.

Shrinking the Safety Net: The 2005 Changes in U.S. Bankruptcy Law

by Robert M. Lawless[*] & Elizabeth Warren[**]

In 2005, the United States enacted the most sweeping changes to its bankruptcy laws in twenty-eight years. We are part of the Consumer Bankruptcy Project, an ongoing project to study who files bankruptcy in the U.S. and why they file. With this dramatic new shift in the law, we are going into the field in 2007 to collect new data. This legal change gives us an opportunity to understand how the bankruptcy system, comparing persons who filed under the new law with our data about filers under the old legal regime. Our goal is to understand how bankruptcy systems work. We are also hoping to learn more from our colleagues around the world, especially those who are interested in asking the same question in their own countries. In the pages that follow, we describe the 2005 changes in the law and how our research project is structured. We invite further discussion about the Consumer Bankruptcy Project from scholars studying bankruptcy in their own countries.

Political Backdrop

Compared with most Western democracies, the U.S. has historically offered its financially needy citizens less generous government assistance. At the same time, U.S. bankruptcy laws have been relatively more generous than those of our counterparts. This paradox is no mere coincidence. Consumer bankruptcy laws are a critical part of the broader social safety net. The more generous U.S. bankruptcy laws partially compensated for the relatively stingy level of government assistance.

While welfare benefits and similar government transfers guaranteed minimal living conditions for the poorest Americans, the bankruptcy system offered protection to families that had accumulated some assets and had future earning potential. Through bankruptcy, these families could protect some of those assets, and they could free their future earning capacity from their past debts. In effect, for those who made it to the middle class, bankruptcy laws assured consumers they would not fall below a minimal standard of living. Facts

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demonstrated the bankruptcy law lived up to this ideal and showed American bankruptcy law has served to protect middle class families. When measured by enduring criteria, such as education, occupational prestige or homeownership, more than ninety percent of those who file for bankruptcy in the U.S. would be deemed solidly middle class.[1]

For years, the consumer credit industry attacked this model of bankruptcy law. Although credit card companies sent out more than five billion pre-approved credit card offers annually, made uncounted numbers of telephone calls, and aggressively solicited customers in shopping malls, college campuses, and sporting arenas, the industry claimed that U.S. consumers were borrowing irresponsibly and then filing bankruptcy. Bankruptcy's moral shame and stigma were said to have disappeared.

Bankruptcy filings rose sharply, making it easy for the consumer credit industry to drum up public interest in the bankruptcy system. By 2005, government statistics showed 1.6 million consumers filed bankruptcy—one in every 71 households in the US—was currently in bankruptcy. The credit industry hired an army of lobbyists and publicists to advance the idea that this rise in filings was proof positive that Americans were flocking to bankruptcy unnecessarily and that the laws should be changed. The industry ignored the fact that consumer credit had risen steadily with bankruptcy filing rates[2] and that the profitability of the credit card companies had increased even as bankruptcy filings had risen.[3]

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[1] Elizabeth Warren, *Financial Collapse and Class Status: Who Goes Bankrupt?* (Lewtas Lecture), 41 OSGOODE HALL LAW REVIEW. 115 (2003). In 2001, 57.2% of U.S. bankruptcy filers had been to college or graduate school, 58.3% of debtors were homeowners, and 70.3% had occupations that scored in the upper 80% of all occupational prestige scores. More than nine out of ten (91.8%) of all debtors had at least one of these criteria for middle class status, 66.6% had two criteria, and 27.4% had all three.

[2] In a forthcoming paper, one of the authors finds statistically meaningful relationships between household debt and U.S. bankruptcy filing rates. Robert M. Lawless, *The Paradox of Consumer Credit*, 2006 UNIVERSITY OF ILLINOIS LAW REVIEW. (forthcoming).

[3] As the bankruptcy law was being considered, press stories constantly appeared touting increased profits at nearly every credit card issuer. *E.g.*, Riva D. Atlas, *Strong Credit Card Portfolio Helps Spur Citigroup Profit*, N.Y. TIMES, Jan. 21, 2004, at C3 ("Citigroup benefited from acquisitions it made last year in its credit card business, where profits rose 23 percent, to $1.14 billion."); *Consumer Business Lifts Profits at Banks*, L.A. TIMES, Jan. 16, 2003, pt. 3, at 3 ("Bank of America earnings rose 27% from the year-ago quarter, while at Cincinnati-based Fifth Third Bancorp they increased 10%. Gains also

The efforts that led to the 2005 law built upon earlier lobbying by the consumer credit industry. In the early 1990s, industry lobbyists had begun to push for a law that would make it more difficult to file bankruptcy in the United States. A 1994 law made a few minor changes,[4] but Congress mostly put off the industry with a promise of a government commission to study the U.S. bankruptcy laws.[5] By the time the Commission delivered its report in October 1997,[6] the credit industry was in full swing, having written its own version of a bankruptcy amendment and persuaded a friendly Congressman to introduce it.

Bankruptcy attorneys, judges, academics and other experts tried to refute the industry's claims. For example, one study showed that the reforms that eventually became law would cause higher repayment from only 3.6% of all bankruptcy filers.[7] One of this article's authors co-wrote a major study showing that one of every two bankruptcy filers was dealing with a major medical problem.[8] Bankruptcy judges and lawyers testified to Congress that the law would ignore the reality of the harsh circumstances in which real-life bankruptcy filers found themselves. One hundred and ten law professors specializing in bankruptcy united to sign a letter denouncing the proposed changes in the bankruptcy law.[9]

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were posted by Midwestern banks KeyCorp and National City Corp. and Southern banks Synovus Financial Corp. and SouthTrust Corp. At Los Angeles-based Cathay Bancorp Inc., profit rose 5%."); *Bank One Profit Rose 27% on Credit Card Fees*, N.Y. TIMES, July 17, 2002, at C1 ("Bank One said today that its second-quarter profit rose 27 percent as it added credit card customers and as fees from deposits and credit cards jumped."); Paul Beckett, *American Express Earnings Jump*, WALL STREET JOURNAL, Oct. 29, 2002, at C9 ("American Express Co.'s third-quarter net income more than doubled, with the rise fueled in part by higher revenue at its flagship credit-cards division and a tighter rein on expenses.").

[4] Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106.

[5] One of us (Elizabeth Warren) was the Senior Adviser and Reporter to the Commission.

[6] NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS (1997) (available at http://govinfo.library.unt.edu/nbrc/reportcont.html).

[7] Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW 27 (1999).

[8] David U. Himmelstein, Elizabeth Warren, Deborah Thorne & Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, HEALTH AFFAIRS (2005) (published online at http://content.healthaffairs.org/cgi/content/abstract/hlthaff.w5.63v1).

[9] The letter was entered into the *Congressional Record*, the official record of the proceedings of the U.S. Congress and can be found at 151 Cong. Rec. H1984 (Apr. 14, 2005).

Experts pointed out that the credit card industry was as profitable as ever, earning $30 billion in profits during 2004.[10]

Arrayed against this expert opinion was the consumer credit industry's exhortation that everyone should pay their debts. The industry claimed that each U.S. citizen paid an extra $400/year in goods and services to cover the costs of debts discharged in bankruptcy. The number was fiction, made up by another industry lobbyist, but with a huge public relations machine behind it, the number was repeated throughout the press and in Congressional debates as if it were hard fact.[11] George W. Bush accepted more money in campaign donations from credit card executives than from any other single source.[12] Collectively, the consumer credit industry gave $8.2 million in campaign contributions during the 2004 elections for president and Congress, and that was on top of the $7.4 million in campaign contributions during the 2002 congressional elections.[13]

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[10] Robin Sidel, *Loss of Balance; Credit Issuers' Problem: People Are Paying Their Bills*, WALL STREET JOURNAL, May 25, 2006, at A1.

[11] For a more detailed discussion of the politics and reality of this claim, see Elizabeth Warren, *The Phantom $400*, 13 JOURNAL OF BANKRUPTCY LAW AND PRACTICE 77 (2004); Elizabeth Warren, *The Market for Data: The Changing Role of the Social Sciences in Changing the Law* (Fairchild Lecture), 2002 WISCONSIN LAW REVIEW 1 (2002); Bruce A. Markell, *Sorting and Sifting Fact From Fiction: Empirical Research and the Face of Bankruptcy*, 75 AMERICAN BANKRUPTCY LAW JOURNAL. 145, 153 (2001).

[12] *See, e.g.*, Robert Zausner & Josh Goldstein, *Bush's Largest Funding Source: Employees of Credit-Card Firm*, PHILADELPHIA INQUIRER, July 28, 2000, at A1 ("By orchestrating mass contributions from its employees, the Wilmington-based company has become Bush's single largest source of campaign money. MBNA employees and their families have given more than $250,000 to the Republican's presidential bid, an Inquirer analysis found."); Christopher H. Schmitt, *Tougher Bankruptcy Laws—Compliments of MBNA*?, BUSINESS WEEK, Feb. 2001, at 43. Schmitt confirmed that MBNA (a leading U.S. credit card company) was "the candidate's single biggest source of cash" and added:

> On the soft-money side, MBNA chipped in nearly $600,000). On top of that, MBNA Chairman and CEO Alfred Lerner and his wife, Norma, each kicked in $250,000 to the Republicans. Charles M. Cawley, CEO of MBNA's bank unit and a friend of Bush Sr., organized fund-raisers and gave $18,660 to Bush and the GOP.

[13] Data on U.S. congressional campaign contributions can be found at http://www.opensecrets.org, a service of the Center for Responsive Politics. The site includes a special section on campaign contributions by parties interested in bankruptcy reform. An academic study finding statistically meaningful relationships between campaign contributions and congressional votes on earlier versions of the bankruptcy law appears at Stephen Nunez & Howard Rosenthal, *Bankruptcy*

The complexity of the bankruptcy laws is legendary, and in the past Congress had turned to academics, practitioners, and judges to provide technical expertise in drafting the bankruptcy laws. Because nearly all of these experts were opposed to the bill, this time they were shut out of the drafting process. Instead, credit industry lobbyists wrote the bankruptcy amendments.[14] Unfortunately, these lobbyists and those who added to the bill over the years were not well versed in either the technical laws or the actual practices of consumer bankruptcy. To complicate matters, the industry continued to engage in negotiations to build its political coalition, offering promises of special protection to more interest groups.[15] When the legislation finally started moving, the legislation's industry and congressional sponsors were concerned that their own coalition might crumble, and they refused to change a single word in the industry-agreed on bill. The final version had serious technical flaws, including a number of mistaken cross-references, misnumberings, and ambiguities that rendered parts of the amendments gibberish.

With simple sound bites and massive campaign contributions, the consumer credit industry drowned out the experts. Republicans along with a large number of Democrats voted for passage of the bankruptcy bill. On October 17, 2005, the most sweeping changes to the U.S. bankruptcy laws since 1978 went into effect, and almost all the changes were bad for consumers.

"Reform" in Congress: Creditors, Committees, Ideology, and Floor Voting in the Legislative Process, 20 JOURNAL OF LAW, ECONOMICS & ORGANIZATION 527 (2004).

[14] *Senate Overwhelmingly Passes Bankruptcy Law*, NATIONAL LAW JOURNAL, Oct. 5, 1998, at A10 ("There is no telling what Mr. Tassey got or didn't get for the [American Financial Services Association's] money. Representative George Gekas took over the House bill. Passages were recast. Amendments and restrictions were added. The bill eventually grew to more than 400 pages. It was no longer the legislation Mr. Tassey advanced and Mr. Wallace [another industry lobbyist] wrote, but the basic concepts remained in place, as did the means test and other features. They'd assure that the coalition would, with a bill's passage, recover from debtors many times the cost of lobbying for the legislation.")

[15] *See, e.g.*, William Whitford, *A History of the Secured Creditor Provisions in BAPCPA*, 2006 UNIVERSITY OF ILLINOIS LAW REVIEW (forthcoming) (exploring tradeoffs between secured auto lenders and other creditor interests in the 2005 bankruptcy amendments).

The Major Changes

The new law made too many changes to the U.S. bankruptcy to summarize all of them in this short space. Instead of giving a catalogue, we focus here on the four changes we believe will have the greatest effect on consumer bankruptcy filers.

Consumer Credit Counseling

Prior to the 2005 Amendments, a debtor could consult with an attorney, fill out a lengthy set of forms, pay a fee, and file for bankruptcy. Now a consumer must now have undergone credit counseling during the 180 days preceding the date of the bankruptcy filing to be eligible for bankruptcy.[16] Banks and credit card companies pointed to the credit counseling as a way the new bankruptcy law would help consumers, but the reality falls far short of that promise. Rather than providing an opportunity for effective credit counseling, the pro-forma counseling offered is more like a hurdle to be crossed—something that consumes time and money but with little benefit. The credit counseling must have occurred with a credit counselor from a list approved by the U.S. Department of Justice. It may take place over the Internet, and providers advertise that it can take as little as twenty minutes.

Without a credit counseling certificate, however, a consumer is ineligible to file for bankruptcy relief. During the first year of the new law, the debtors without an attorney to guide them are the ones who most often fail to get credit counseling. In addition to having their cases dismissed, these debtors face two potential consequences. First, the new law states that a consumer who files a second bankruptcy case within one year of the dismissal of a previous case will lose the protections of a bankruptcy court after 30 days.[17] Second, they may lose the $299 filing fee for a basic consumer bankruptcy, a considerable sum to someone in need of bankruptcy relief. Because the new law treats credit

[16] 11 U.S.C. § 109(h).
[17] *Id.* § 362(c)(3).

counseling as a requirement to be eligible to file bankruptcy, some bankruptcy courts have treated a filing without a credit counseling certificate as a nullity.[18]

One doctrinal wrinkle with the credit counseling requirement was its wording. Because the statute specifies that consumer credit counseling must occur in the 180 days *preceding the date on which bankruptcy is filed*, the question is whether a consumer may undergo credit counseling on the day of the bankruptcy filing. Because credit counseling can be a short session over the Internet, many attorneys offer this service at their office. There is no rational reason why Congress would have demanded that credit counseling not occur on the day of the bankruptcy filing, but two bankruptcy courts already have ruled that the statute has to be applied as written.[19] This one-day waiting period before filing bankruptcy offers just one illustration of how poorly written is much of the new legislation. Courts have expressed their frustration with this sort of incomprehensible and illogical language spread throughout the statute.[20]

In addition to the requirement that a consumer go for credit counseling before filing bankruptcy, a consumer must take additional instruction during the

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[18] Under this logic, the debtor can obtain credit counseling and then return to bankruptcy court as if it were the initial filing, retaining the protection of the bankruptcy court and avoiding a second filing fee.

[19] *See In re* Cole, 347 B.R. 70 (Bankr. E.D. Tenn. 2006); *In re* Mills, 341 B.R. 106 (Bankr. D. Colo. 2006). *But see In re* Warren, 339 B.R. 475 (Bankr. E.D. Ark. 2006) (reaching opposite conclusion).

[20] Consider the language of Bankruptcy Judge Frank Monroe when ruling on an issue involving the credit counseling requirements:

> The Congress of the United States of America passed and the President of the United States of America signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act"). It became fully effective on October 17, 2005. Those responsible for the passing of the Act did all in their power to avoid the proffered input from sitting United States Bankruptcy Judges, various professors of bankruptcy law at distinguished universities, and many professional associations filled with the best of the bankruptcy lawyers in the country as to the perceived flaws in the Act. This is because the parties pushing the passage of the Act had their own agenda. It was apparently an agenda to make more money off the backs of the consumers in this country. It is not surprising, therefore, that the Act has been highly criticized across the country. In this writer's opinion, to call the Act a "consumer protection" Act is the grossest of misnomers.

In re Sosa, 336 B.R. 113, 114 (Bankr. W.D. Tex. 2005).

bankruptcy case. If the consumer fails to do so, there will be no discharge of debts in bankruptcy—regardless of the merits of the case.[21]

Means Testing

The new bankruptcy law also tests who is eligible for different forms of bankruptcy relief through a complicated formula that tests a consumer's ability to repay her debts.[22] The idea was to force more people into a partial repayment plan under chapter 13 of the U.S. Bankruptcy Code. Debtors who fail this means test must file under chapter 13 rather than choose a chapter 7 filing where the debtor receives a discharge after turning over any assets not exempt from judicial process and not subject to a security interest. In most consumer chapter 7 filings, the debtor has no such assets, meaning there are no distributions to creditors.

The new means test first asks whether the debtor earns an income above or below the median for the same size household in the debtor's state.[23] If the debtor is below the median, that is the end of the inquiry, and the debtor may file for chapter 7. Virtually no debtors are reporting above-median incomes. At one point, a bankruptcy judge told us that in his district there were only two debtors above the median out of two thousand filers. Although supporters of the new law claim this shows that abusive, above-median filers have been eliminated from the system,[24] we believe a simpler explanation exists. Prior to 2005, the debtor's reported income did not have a significant effect on the case. Now, the dollar figure of income has a powerful effect. Not surprisingly, debtors and their attorneys are more carefully scrutinizing the income reported in the official bankruptcy forms. Debtors with spotty work histories are well advised to pick a time for bankruptcy that will leave them with a low-income calculation. Because the allowed income changes based on the size of the household (not the family), debtors with higher incomes are also encouraged to consider asking grandma to move in or to list a child with whom the debtor may share custody with a divorced spouse. The debtor and her lawyer resolve any ambiguities in the

[21] *See* 11 U.S.C. §§ 727(a)(11), 1328(g)(1)

[22] *See* 11 U.S.C. § 707(b)(2)(A)

[23] The statutory provisions on the means test are nearly incomprehensible, and persons interested in its actual operation are well advised to examine the official court form for its implementation, which is available at http://www.uscourts.gov/rules/BK_Forms_06_Official/Form_22A_1006.pdf.

[24] *Bankrupt Opposition*, WALL STREET JOURNAL, Oct. 25, 2006, at A14.

statutory rules—and there are many such ambiguities—with the interpretation most favorable to the debtor. The amendments have created the opportunity for more creative reporting.

For debtors with above-median incomes, the means test then turns to a complex formula to determine whether the debtor has enough disposable income to fund a chapter 13 plan. The formula is based on standards developed by the Internal Revenue Service (the federal taxing authority) to determine whether to compromise tax debts with taxpayers. Although the Internal Revenue Service intended these guidelines as internal operating guidance, Congress enshrined them in the new law. As a result, changes in federal tax collection policies could have an important effect on the bankruptcy system.

Even if the debtor has enough disposable income to fund a chapter 13 plan, Congress mandated that other deductions be considered. For example, the debtor is allowed to deduct any payments made for a secured obligation or for private health insurance. These rules can create perverse incentives for consumers to spend and borrow *more* money before filing bankruptcy. A consumer who on the eve of bankruptcy gets a car loan for an expensive automobile can deduct those payments for purposes of the means test and remain eligible for chapter 13.

Because of the paucity of debtors with above-median incomes, the minutiae of the mean-testing provisions have not yet generated much litigation. One case that did attract some attention was the ruling of a bankruptcy court that the 2005 law changed provisions of the Bankruptcy Code allowing a chapter 13 debtor to devote up to 10 percent of her income to religious or charitable contributions.[25] Although one might think that the same politicians who pushed the 2005 law would not be sympathetic to debtors who wanted to make charitable contributions with their creditors' money. That did not prove to be the case. Other politics intervened, and the politically powerful religious groups made their concerns known. As a result, some of the most vociferous advocates of the 2005 law quickly introduced a bill in Congress that would overturn the court decision, despite the fact that it was only one decision from a lower court in upstate New York and it therefore had no precedential effect in other courts.[26]

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[25] *In re* Diagostino, 347 B.R. 116 (Bankr. N.D.N.Y. 2006)

[26] Religious Liberty and Charitable Donation Clarification Act of 2006, S. 4044, 109th Cong., 2d Sess. As of this writing, the bill was still pending in the U.S. Congress.

Burdens on Attorneys

The new law imposes significant burdens on attorneys. A U.S. consumer bankruptcy filing can run dozens of pages and includes detailed schedules of the debtor's assets and liabilities. Under the new law, the debtor's attorney must represent to the court that she has made an inquiry and has no reason to believe any of this information is incorrect.[27] Previously, attorneys could not knowingly submit false bankruptcy schedules, but the consumer had primary responsibility to ensure the schedules were accurate. Now, the attorney must vouch for the accuracy of the schedules and has to take a suspicious stance against the client. Attorneys who violate these provisions are subject to penalties and may have to pay creditors' court costs.[28]

Other new provisions of the statute deal with debt relief agencies.[29] In the U.S., there have been abuses with businesses that offer help to consumers in filing bankruptcy cases, and the debt relief agency provisions originally were directed at these businesses. Congress drafted the new law broadly so that consumer bankruptcy attorneys also are swept into the definition of debt relief agencies.[30] Bankruptcy attorneys must make voluminous disclosures to their clients and identify themselves as debt relief agencies to their clients.[31] One provision of the new law even limits the advice that attorneys can give to their clients, prohibiting an attorney from advising a client to incur more debt before filing bankruptcy.[32] Three courts already have struck down that provision as violating the U.S. Constitution's guarantee of free speech.[33]

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[27] 11 U.S.C. § 707(b)(4)(C)-(D).
[28] *Id.* § 707(b)(4)(B).
[29] *Id.* §§ 526-528.
[30] The law defines a "debt relief agency" as any person who gives "bankruptcy assistance" to an "assisted person." *Id.* § 101(12A). In turn, "bankruptcy assistance" is providing goods or services for the purpose of providing information or advice to someone about to file bankruptcy. *Id.* § 101(4A). An "assisted person" is a consumer with less than $150,000 in nonexempt assets. *Id.* § 101(3).
[31] *Id.* § 527.
[32] *Id.* § 526(a)(4) (preventing a debt relief agency from advising a person to incur more debt before filing a bankruptcy case).
[33] *See* Zelotes v. Martini, No. 3:05cv1591 (D. Conn. Nov. 7, 2006); Olsen v. Gonzales, No. 05-6365-HO (D. Ore. Aug. 11, 2006); Hersh v. United States, 347 B.R. 19 (N.D. Tex. 2006).

The end result is that attorneys' fees have increased dramatically for consumer bankruptcies. Although hard data are hard to come by, some claim that attorneys' fees have increased 50-100%, depending on the locale. Reports suggest it now costs a typical consumer over $1,000 to file a routine chapter 7 bankruptcy case, with some fees as high as $1,500. Chapter 13 cases or cases presenting substantial legal issues will cost even more. These attorneys' fees are on top of the newly increased $299 filing fee and the expense of pre-filing consumer credit counseling and post-filing consumer education. As a result of these changes, consumer bankruptcy filings have plummeted since the 2005 bankruptcy law. The filing rate for 2006 will be somewhere between 35-40% of what it was in previous years.

Audit Requirements

The 2005 law also put in place random audits of the information in consumer bankruptcy petitions.[34] Although this change has not attracted as much attention as other portions of the new law, we believe it will have important effects. The law decrees that one of every 250 cases shall be randomly audited under procedures established by the Executive Office for U.S. Trustees, an arm of the U.S., Department of Justice. In addition, there shall be an audit of every cases where the schedule of income and expenses that reflects "greater than average variances from the statistical norm of the district in which the schedules were filed." To allow time for its implementation, this rule was delayed and did not go into effect until October 2006.

There is again a problem of sloppy legislative drafting. In statistics, variance is a term generally used to describe a sample or population. Thus, a sample of schedules of income and expenses would have variance, but a single schedule in the sample would not. The single schedule would deviate from the population (or sample) variance. Perhaps it might be possible to solve all the definitional problems by concluding that Congress mandated audits of schedules further away from the average than the average schedule. But such a reading runs directly into another mathematical fact. Assuming a normal distribution (i.e., a bell curve), approximately 33% of the observations will be further away from the average than the average observations. In other words, if this is the interpretation,

[34] *See* 28 U.S.C. § 586(f).

then Congress appears to have mandated audits for 33% of all bankruptcy filings, in addition to the one in 250 random audits. With hundreds of thousands of bankruptcy filings each year, that percentage would result in huge numbers of audits. Our guess is that we will not see so many audits. Rather, the Office of the United States Trustee is likely to develop a rule of thumb to determine which suspicious schedules are audited.

In the long run, the audit rules will have a subtle, but pervasive effect on debtor filings. Intentional misstatements are grounds for revocation of the bankruptcy discharge[35] and can result in a five-year jail sentence for bankruptcy fraud.[36] Debtors who intentionally mislead the bankruptcy court should be punished, but with perfect hindsight, any misstatement can appear to have been intentional. Misstatements on the bankruptcy schedules also can be grounds for sanctions against the debtor's attorney. Rather than risk penalties and sanctions, it is possible that most attorneys will advise consumer debtors to take more conservative estimates in their bankruptcy schedules, this circumscribing the protection available to debtors. By contrast, there are no corresponding penalties for creditors who take aggressive positions against debtors. Debtors who do not have the financial resources to fight their creditors will have little recourse. Ironically, the random audits, which appear to do nothing more than assure accuracy in the system, are yet another way the 2005 law will work against consumer debtors in bankruptcy court.

Hypotheses about the New Law

The previous section considered the most significant changes in U.S. bankruptcy law. In addition to the changes we discussed, there were many other changes to both consumer and business bankruptcy law. The 2005 law was 513 pages long and greatly expanded the complexity of the Bankruptcy Code. Indeed, the University of Illinois (one of the authors' schools) is among the law schools that have responded to this increase in complexity by expanding the number of credit hours devoted to teaching bankruptcy law to students.

The new bankruptcy laws will make it more difficult for consumers to get to bankruptcy court, and they will find less effective relief once they get there. We

[35] 11 U.S.C. §§ 727(d), 1328(e).
[36] 18 U.S.C. § 157.

are only one year into the new legal regime, and we lack hard data to know with certainty about how the law has changed the bankruptcy system. As we prepare to gather this data, however, we have the following hypotheses about U.S. bankruptcy filings.

- Consumers will be leaving bankruptcy court with more obligations.
- Because bankruptcy is costlier and provides less relief, consumers will delay filing bankruptcy. They will arrive in bankruptcy court more financially distressed than previously. A contradictory hypothesis focusing on the increased costs might predict the opposite result. Higher costs could price the most financially distressed debtors out of the market, leaving only relatively "wealthier" debtors to file bankruptcy.
- Because costs will change the financial characteristics of who files bankruptcy, the demographic makeup of bankruptcy filers also will change.
- More bankruptcy cases will be dismissed without a full adjudication. Even a quick inspection of court dockets reveals that many cases are now being challenged for failing to meet onerous new paperwork requirements.

The next section considers the methodology we will use to collect data and test these hypotheses.

Consumer Bankruptcy Project 2007

These hypotheses are only assertions. Law needs to be measured by its actual effects, not by claims made in the law journals. Increasingly, the U.S. legal academy is turning to empirical legal studies to measure the reality of what happens in the legal system. Law professors who study commercial and bankruptcy law have led this intellectual movement. Indeed, they have been doing empirical studies before there was a discernible trend in the U.S. legal academy toward such studies.

In 1981, one of this paper's authors (Warren) joined with Jay Westbrook and Teresa Sullivan to start the Consumer Bankruptcy Project. This project collected information from more than 1,500 households that had filed under what was the newly enacted U.S. Bankruptcy Code. In 1991, Warren, Westbrook, and

Sullivan again returned to the field. By 2001, the project had grown to include twelve scholars from seven universities. In addition to three books, this work has resulted in the publication of over four dozen articles in scholarly journals and the support for substantial press coverage of bankruptcy.

We are privileged to be part of a new interdisciplinary team of eleven researchers at six universities that make up the Consumer Bankruptcy Project 2007 or CBP 2007.[37] We plan to survey and collect court records of more than 2,000 consumers who will file bankruptcy in early 2007. In addition, we expect to conduct an extensive telephone interview with approximately a quarter of those who complete the written survey.

The Consumer Bankruptcy Project 2007 has been organized around a "hub and spoke" concept. For the hub, we will collect a core of basic data about all of the cases in our study. These basic data will include demographic information, employment information, schedules of income and expenses, lists of assets and liabilities, self-identified causes of the bankruptcy filing, and information about the resolution of the bankruptcy case.

The researchers have different areas of interest, which we think of as the project's spokes. One researcher will focus on the self-employed who have filed for bankruptcy, comparing the decisions they made with what we know about entrepreneurs who have not filed bankruptcy. Another researcher is interested in how consumer financial distress affects family dynamics, including questions of domestic violence and the relative roles of men and women within a family. Because the U.S. lacks a universal health care system, the project also will focus on how consumers deal with the financial fallout from medical problems and whether unpaid medical bills are a major cause of consumer bankruptcy. Still other researchers will use the data to examine housing issues, while another researcher is interested in financial distress in U.S. rural areas.

We are in the beginning stages of coordinating our research with scholars in other countries. Our hope is that scholars in other countries would administer similar survey instruments to persons seeking bankruptcy relief in their own countries. By coordinating data collection across several countries at roughly the

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[37] In law, we are joined by Margret Bell (Boston College), Melissa Jacoby (University of North Carolina), Angela Littwin (Harvard University), Katherine Porter (University of Iowa), and John A.E. Pottow (University of Michigan); in medicine by David Himmelstein (Harvard University) and Steffie Woolhandler (Harvard); in sociology by Teresa Sullivan (University of Michigan) and Debb Thorne (Ohio University); and in urban planning by Eric Belsky (Harvard University).

same time, there would be an opportunity to learn about why people find themselves in financial distress and compare cultural and legal differences across countries. We would welcome inquiries from university-affiliated scholars who are interested in working on such a project.

The end result of the Consumer Bankruptcy Project will be a variety of publications in a variety of different disciplines. As we see it, each publication adds to what is known about household financial distress, and each helps build toward a better understanding of the policy objectives of bankruptcy relief and how the laws might be better structured to accomplish that relief.

Conclusion

Bankruptcy law is deeply woven in the American social safety net. It has also become woven into the American political scene. The powerful influence of campaign contributions and lobbying dollars clearly carried the day for the 2005 amendments, but political winds may blow from the other direction again. While those who represent consumers will never have the financial clout of a multi-billion dollar industry, the public attention paid to the bankruptcy laws has surprised many politicians. There is considerable discussion that the new laws are too harsh and that they were the product of a corrupt process.

Whether change comes quickly or slowly, and whether it is friendlier to consumers or continues to favor creditors, the importance of empirical work cannot be overstated. It provides a critical link between policy ideas and reality. Politicians may ignore that link for a while, but no one can ignore it forever. Reality has a way of asserting itself, and when it does, the laws will change again.